

John D. Reiss, Nathan J. Greene and Malcolm K. Montgomery on
**The Financial Crimes Enforcement Network and Other Anti-Money
Laundering Regulators Sharpen Their Focus on the Real-Estate Industry
as the Panama Papers Underscore Global AML Concerns**
2016 Emerging Issues 7415

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The U.S. Financial Crimes Enforcement Network, or FinCEN, is the bureau of the Department of the Treasury with principal responsibility for implementing anti-money laundering rules and regulations. Earlier this year, acting pursuant to authority under the U.S. Bank Secrecy Act, FinCEN (pronounced “Fin-Sen”) released what it called Geographic Targeting Orders (GTOs) and a related FAQ dealing with transactions in U.S. residential real estate.¹ FinCEN acted following high-profile press reports alleging the use of shell companies by various bad actors (e.g., corrupt foreign officials, international criminals and the like) purchasing high-end residential real estate in major markets.² While the practical scope of the GTOs appears limited for reasons we explain below, expansion is possible (and perhaps likely).

Fresh FinCEN attention to shell companies is also pending and likewise has been linked in the press to residential real estate. More broadly, FinCEN’s approach appears emblematic of rising anti-money laundering (AML) scrutiny of the real estate sector generally, both in the U.S. and globally. Additionally, in April 2016 the International Consortium of Investigative Journalists published a large volume of leaked documents relating to corporations allegedly established for clients of Panamanian law firm Mossack Fonseca, some of which referenced by name or implication various politicians and other public officials.³ The release of these so-called “Panama Papers” and the resulting media coverage have drawn significant attention to issues of global money laundering and corporate anonymity. Against this backdrop, even the simple appearance of impropriety in legitimate business structures can present special risks.

The Geographic Targeting Orders

The GTOs cover “cash” purchases by a legal entity of any residential property in Manhattan with a purchase price over \$3 million, and in Miami-Dade County, Florida with a purchase price of more than \$1 million (covered transactions). The GTOs became effective March 1, 2016 for a period of 180 days (expiring August 27, 2016), and the responsibility for the required reporting and compliance falls to title insurance companies, who appear to have been generally accepting of the initiative.

Under the GTOs, a title insurance company must file FinCEN Form 8300 with respect to any covered transaction with which it is involved. The Form 8300 must be filed within 30 days of closing and must

1 FinCEN Takes Aim at Real Estate Secrecy in Manhattan and Miami, January 13, 2016, available at: https://www.fincen.gov/news_room/nr/html/20160113.html.

2 See, e.g., Stream of Foreign Wealth Flows to Elite New York Real Estate, New York Times, Feb. 7, 2015, available at: <http://www.nytimes.com/2015/02/08/nyregion/stream-of-foreign-wealth-flows-to-time-warner-condos.html>.

3 See International Consortium of Investigative Journalists, The Panama Papers: Politicians, Criminals and the Rogue Industry That Hides Their Cash, <https://panamapapers.icij.org/>.

include the purchase price and date of the transaction, the address of the residential property, the identity of the individual primarily responsible for representing the purchaser (together with a copy of such individual's driver's license, passport, or other identifying documentation), and the identity of the beneficial owner(s) of the purchaser (together with a copy of such individuals' driver's license, passport, or other identifying documentation).⁴ The GTOs define "beneficial owner" as each individual who directly or indirectly owns 25% or more of the equity interests in the purchaser.

FinCEN's FAQ that accompanied the GTOs clarified their reach in several respects. The GTOs stipulated that, to qualify as a covered transaction, the purchase must be made without a bank loan or other external financing, and must be "made, at least in part, using currency or a cashier's check, a traveler's check, or a money order in any form." Notably, the GTOs did not reference purchases made fully by wire transfer, even though such purchases are commonly thought of as "cash" purchases (and are perhaps the most prevalent form of such purchases). The FAQ, however, confirms that such a purchase does not qualify as a covered transaction, unless partial payment is also made in one of the specifically enumerated other forms.⁵

FinCEN's rationale for excluding purchases by wire transfer may be that bank customers have presumably already undergone an AML-vetting process.⁶ Given this exclusion, however, many observers are skeptical about the practical coverage of the GTOs, and it is at least debatable whether FinCEN intended the scope of the GTOs to be so narrow.⁷ Indeed, early reports post-effectiveness indicate that the GTOs have had little to no impact in the market.⁸ Even if payment is made in one of the specified forms, the GTOs would not apply to customers who opt to proceed without title insurance or who buy outside of Miami-Dade County or Manhattan. It is also unclear if the GTOs would apply in circumstances whereby a purchaser delays the acquisition of title insurance until sometime after the closing.

We understand from our discussions with major New York title insurers that, in light of the GTOs, they generally now require a certification from the purchaser at closing that either (1) the transaction is not a covered transaction (which could be the case for various reasons, including that one of the specified forms of payment is not being used or simply that there is no single 25% or more owner of equity interests in the purchaser), or (2) the transaction is a covered transaction, in which case the Form 8300 information is collected and submitted.⁹ Additionally, title insurers are generally

4 The FAQ further defines the "individual primarily responsible for representing the Purchaser" to mean the individual "authorized by the entity to enter into legally binding contracts on behalf of the entity."

5 Interestingly, a recent speech given by FinCEN's director seems to gloss over the specific FAQ guidance on wire transfers. In referring to the GTOs, she states "And to be clear, when I say 'all cash' I am not necessarily talking about hard currency in a duffle bag, but rather properties purchased without a mortgage". Jennifer Shasky Calvery, ACAMS AML and Financial Crimes Conference, Hollywood, Florida, April 12, 2016, available at: https://www.fincen.gov/news_room/nr/pdf/20160412.pdf.

6 As per the FAQ, a purchase paid in full by uncertified personal check would also appear not to qualify as a covered transaction (although such purchases are rarely, if ever, made in the market).

7 See, e.g., New Rule May Miss Target on Real-Estate Purchases, Wall Street Journal, February 24, 2016, available at: <http://www.wsj.com/articles/new-rule-may-miss-target-on-real-estate-purchases-1456223402>.

8 See, e.g., Pace of Cash Luxury Sales Suffers Little After Feds Take Look, Daily Business Review, March 19, 2016, available at: <http://www.dailybusinessreview.com/id=1202752553014/Pace-of-Cash-Luxury-Sales-Suffers-Little-After-Feds-Take-Look>.

9 We note that the FAQ specifically states that, in complying with the GTOs, a title insurance company "may reasonably rely on information provided to it by third parties, including other parties involved" in the covered transaction.

amenable to confidentiality agreements prohibiting disclosure by the title insurer of a purchaser's Form 8300 information to parties other than FinCEN.

New Rules for "Shell Companies"

Meanwhile FinCEN is reported to be putting the finishing touches on an enhanced customer due diligence (CDD) rule for banks and certain other regulated financial services businesses, which will be required to do more to identify ownership of the companies whose accounts they handle.¹⁰ As FinCEN's director Jennifer Shasky Calvery describes the rule: "[It] would clarify and make absolutely clear to our financial institutions that they must know and understand the beneficial ownership of their customers ... We already know that they need to know their customer, but where that customer is a legal entity, we are clarifying that they need to know and understand the beneficial owner of that customer. Who is actually calling the shots? Who stands to gain?"¹¹ Implementation of the new rule has been explicitly linked in the press both with the fallout from the Panama Papers and with continued attention to U.S. residential real estate transactions, all of which likely will drive continuing regulatory attention.¹²

AML Rules for Real Estate Advisers

Also pending are proposed rules prescribing minimum standards for AML programs for investment advisers registered with the U.S. Securities and Exchange Commission, as well as a requirement for those advisers to report suspicious activity to FinCEN.¹³ Given that many real estate private equity managers are now registered as investment advisers with the SEC, the rules could be an additional lever for FinCEN in collecting reports and imposing standards on the real estate industry.¹⁴ Under the rules, real estate managers may need to develop additional screening, diligence and reporting requirements when accepting third party investments into their funds or direct co-investments in U.S. real estate, or when dealing with developers or other joint venture partners.

Focus on the Real Estate Industry More Broadly

FinCEN is not alone in focusing on increased transparency and reporting in real estate transactions. A senior official of the U.S. Federal Bureau of Investigation (FBI) has been quoted as supporting expansion of the timeframe and geographic reach of the GTOs.¹⁵ A new FBI unit focusing on AML

10 See Treasury Issues Proposed Rules to Enhance Financial Transparency, July 30, 2014, available at: <https://www.treasury.gov/press-center/press-releases/Pages/jl2595.aspx>.

11 See U.S. Plans to Require Banks to Identify Owners of Shell Companies, New York Times, Apr. 6, 2016, available at: http://www.nytimes.com/2016/04/07/world/americas/us-plans-to-require-banks-to-identify-owners-of-shell-companies.html?_r=0.

12 Id.

13 See our prior Client Publication entitled "Financial Crimes Enforcement Network: Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers", available at: <http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/09/Financial-Crimes-Enforcement-Network-Anti-Money-Laundering-Program-and-Suspicious-Activity-Report-Filing-Requirements-for-Registered-Investment-Advisers-IF-090815.pdf>.

14 We note that the GTOs themselves may have limited relevance to most private equity real estate managers, with the potential exception of firms that develop condominiums and sell individual units, for example.

15 See U.S. Will Track Secret Buyers of Luxury Real Estate, New York Times, Jan. 13, 2016, available at: http://www.nytimes.com/2016/01/14/us/us-will-track-secret-buyers-of-luxury-real-estate.html?_r=0.

also has been created, and real estate may be a key area of interest. A January 2016 report released by Global Witness also urges widespread expansion of the GTOs, public disclosure of related beneficial owner information, and AML obligations for real estate agents and escrow agents.¹⁶

Additionally, the New York City Department of Finance in 2015 amended Form NYC-RPT, the transfer tax return filed with the city upon a transfer of real estate, to require identifying information for all members of a limited liability company involved in the transaction as grantor or grantee.¹⁷ Effectiveness of this action is again debatable, as disclosure of the ultimate beneficial owner is not required and the issue of simply interposing another layer of “shell” ownership, which would seem to defeat the purpose of the form amendment, is not well addressed. However, this action is potentially a first step and is in keeping with the pending FinCEN shell company rule described earlier and with broader trends toward tighter oversight generally.

Looking globally, FinCEN’s actions echo similar regulatory scrutiny in the United Kingdom, and other international financial centers with high-end real estate markets could also be ripe for further regulatory attention.¹⁸ The U.K.’s first national risk assessment of anti-money laundering and terrorist financing, published in October 2015, revealed significant intelligence gaps in the area of high-end money laundering where the proceeds are held in real estate.¹⁹ Additionally, the U.K. Department of Business Innovation & Skills recently released a discussion paper and sought comment on requiring companies headquartered outside of the U.K. to provide information on their beneficial ownership before being able to purchase land or property in England and Wales.²⁰ The information would likely be stored in a public register²¹, and purchasers of property would need to engage an English law firm on the transaction, who would be required to carry out AML checks and report any suspicions of money laundering to the U.K. National Crime Agency.

Collectively, the regulatory efforts described above suggest a pattern: authorities are increasingly viewing the real estate industry as an industry that should be subject to AML requirements akin to

16 Lowering the Bar, How American Lawyers Told Us How To Funnel Suspect Funds Into The United States, January 2016, available at: <https://www.globalwitness.org/shadyinc/>.

17 See NYC-RPT Form and Instructions, available at: <http://www1.nyc.gov/assets/finance/downloads/pdf/08pdf/nyc-rpt.pdf>

18 See Dubai Suitcases of Cash Circumvent Loan Rules; Mortgages, January 29, 2013, available at: <http://www.bloomberg.com/news/articles/2013-01-28/dubai-suitcases-of-cash-circumvent-loan-rules-mortgages>.

19 See UK National Risk Assessment of Money Laundering and Terrorist Financing, October 2015, available at: <https://www.gov.uk/government/publications/uk-national-risk-assessment-of-money-laundering-and-terrorist-financing>. Prime Minister David Cameron has also spoken out publicly against the use of London real estate for money laundering purposes. See Foreign Crooks Are Laundering Billions in London Real Estate, CNNMoney, July 28, 2015, available at: <http://money.cnn.com/2015/07/28/news/london-real-estate-money-laundering/>; Call For Greater Transparency in Prime London Property Deals, Financial Times, July 22, 2015, available at: <https://next.ft.com/content/2953abea-2f90-11e5-8873-775ba7c2ea3d>.

20 See Beneficial Ownership Transparency: Enhancing Transparency of Beneficial Ownership Information of Foreign Companies Undertaking Certain Economic Activities in the UK, March 2016, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/512333/bis-16-161-beneficial-ownership-transparency.pdf. The discussion paper also proposes requiring that any company that enters into a public procurement process with the U.K. Government should be required to disclose its beneficial ownership.

21 The proposed approach mirrors, to a certain extent, the new requirements for U.K. incorporated companies to keep information on their beneficial ownership and control, which will, from the end of June 2016, be required to be provided to Companies House to be included in a separate register of people with significant control (known as the “PSC register”). See our related Client Publication entitled “The New PSC Regime”, dated March 23, 2016, available at: <http://www.shearman.com/~media/Files/NewsInsights/Publications/2016/03/The-New-PSC-Regime-MA-032316.pdf>.

those applicable in the banking and finance industry. While measures to date have been somewhat limited in their scope and impact, real estate industry participants should not be surprised to see them expanded upon. This is especially so given that rising economic populism and an era of blogger and activist driven investigative journalism will likely keep “secret wealth” as a headline topic for the foreseeable future.

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The authors would also like to thank Associate **Jo Xu** and Professional Support Lawyer **Sandy Collins** for their assistance with this article.

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